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E.O. 12958: DECL: 08/02/2016  
TAGS: [ECON](#)  
SUBJECT: ECUADOR-VENEZUELA DEAL COLLAPSES, PALACIO CANCELS  
CRUDE AUCTION

REF: A. QUITO 01612

[1](#)B. QUITO 01887

Classified By: EconOff Sara Ainsworth, for reasons 1.4 (b&d)

[1](#)1. (SBU) Summary. After two months of wrangling over details, Petroecuador's and Venezuelan PDVSA's plan to swap Ecuadorian crude for refined products appears finally to have collapsed. (reftel A) The deal was uneconomical and technically untenable from the beginning, and Venezuela apparently determined that the political benefits would not outweigh the disruptions to its refineries. The deal's collapse compelled Ecuador's government (GOE) to solicit offers for over 17 million barrels of crude from Block 15, recently co-opted from Occidental Petroleum (Oxy). The GOE originally scheduled the auction for July 27, but after receiving limited interest, rescheduled the auction to August [1](#)4. Many industry insiders also see the postponement as an attempt by President Palacio to give preference to state-owned companies, underrepresented in the first set of bids. End summary.

Crunching Numbers With Political Calculus  
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[1](#)2. (SBU) The oil exchange agreement between Ecuadorian state oil company Petroecuador and its Venezuelan counterpart PDVSA, was from the beginning a political calculation meant to demonstrate the benefits of the Oxy takeover. One energy insider posits that Chavez and Palacio laid the groundwork for the deal in May during the EU-Latin America Summit in Vienna without considering the deal's economic and technical problems.

[1](#)3. (U) In the months after signing the memorandum, the GOE pushed PDVSA to provide concrete numbers that would demonstrate the economic merits of the deal. Market fundamentals dictated that the benefit to Ecuador would fluctuate monthly subject to several variables including consumer demand and the supply and inventory of crude and refined products, all of which would affect daily market reference prices. Another technical barrier to the deal was the legal requirement that all Ecuadorian crude be shipped by monopoly firm Flota Petrolera Ecuatoriana.

[1](#)4. (SBU) An independent energy consultant told EconOff that

former Minister of Economy Borja has ties to presidential candidate Rafael Correa, and that both are friendly with Chavez. He suggested that Borja dreamed up the putative deal's benefits to Ecuador in a public relations campaign aimed at highlighting the economic wisdom of canceling Oxy's contract. When Borja couldn't win over the media, the GOE started asking Venezuela for revised numbers.

Venezuela: Even Ideology Has A Bottom Line  
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15. (U) Despite public efforts to demonstrate solidarity with Ecuador, in the end Venezuela appeared to be motivated by profit. The agreement would have upset the balance in Venezuelan refineries, requiring time to switch from treating Venezuelan crude to Ecuadorian Napo crude. Sending Ecuadorian crude to Citgo refineries in the US would have been problematic because shipping through the Panama Canal is expensive and logistically challenging. One energy insider believes that in the end Venezuela probably realized that the benefits, whether political or economic, would not compensate for the disruptions to its refineries.

Pssst... Wanna Buy Some Crude?  
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16. (U) After the collapse of the PDVSA deal, the GOE announced that it was accepting offers for an eight-month purchase agreement for 17 million barrels of Napo crude from Block 15, which would be awarded July 27. Twenty minutes before opening the sealed bids, President Palacio canceled the auction. The GOE then publicly announced that the auction would be postponed until August 4, giving potential buyers (public and private) more time to present their bids. According to a Petroecuador insider, Palacio earlier had

asked Minister of Foreign Affairs Carrion to invite the Indian oil company and other state-owned firms to participate in the bidding process. In the event, the Indonesian state energy company was the only state-owned company to bid. On July 31, Minister of Economy Rodas explained that several state-owned firms had received their invitations too late to submit bids. Palacio reportedly disagreed with the manner in which Petroecuador's Board of Directors managed the auction. He is now facing an investigation by the Attorney General for his haphazard decision to postpone.

Comment  
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17. (C) The USG should welcome the collapse of the Venezuela-Ecuador crude-for-refined products deal, but for Ecuador the underlying problems remain. It spends more than \$1 billion importing refined products every year and Petroecuador still must find buyers for more than 2 million barrels of crude produced every month from Block 15. Government contacts told us that a few well-placed Ecuadorians have been profiting off the crude sold on the spot market; they may have played a role in scuttling the Venezuela deal. New Petroecuador President Galo Chiriboga (reftel B) has also said he will try to restart negotiations with Venezuela.

18. (C) Petroecuador is likely to suffer the consequences of President Palacio's rash decision to postpone the auction. Four members of the company's Board of Directors have been scapegoated and replaced in the hiatus between auctions. Several of the company's best customers have said they will not submit bids again, including Glencore and Shell Trading. The crude is likely to continue selling at a steep discount, as global refineries are reportedly at capacity until September, and Ecuador needs to offload its oil due to storage limitations. End comment.

BROWN